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MEMORANDUM

JUN 22 1993

To: John Winston, Director
Small Business Advisory Committee
Federal Communications Commission

May 20, 1993

From: Andrea L. Johnson, Director
Al Simon Center for Telecommunications
California Western School of Law

Re: Spectrum Auctions for Personal Communications Service (PCS)

This is in response to your request for my comments on the impact of using spectrum auctions to license Personal Communications Services (PCS) on small and disadvantaged businesses. Specifically, this memo will outline the current debate over use of spectrum auctions for PCS and other similar technology, summarize the general issues to be resolved regarding spectrum auctions, and how small business interests can be protected.

I. Background

PCS is a type of portable two-way wireless cellular technology that provides the same services as traditional telephone services.¹ PCS is marketed as being more advantageous than traditional cellular or telephone wire equipment because it is lighter, portable, and covers a wider area without interference.² PCS can be used for wireless telephony, facimiles, data transmission, an interactive modem, and other switched services.³

Congress⁴ and the Federal Communications Commission⁵ (FCC)

¹ Minority Business Development Agency, U.S. Dept. of Commerce, Market Analysis of the Telecommunications Industry-Vol 2 34 (1991)

² Id.

³ Kathleen Killete, "PCS Facing Obstacles--And even when the problems are solved, will users need the technology?", COMMUNICATIONS WEEK, p 25 (April 8, 1991)

⁴ The House Telecommunications Subcommittee passed a spectrum auction bill on May 6, 1993 authorizing the FCC to use auctions in licensing new technology. Sean Scully, "Telcomsubcom Passes Auction Bill", BROADCASTING p 36 (May 10, 1993). The Senate Commerce Committee is currently considering a similar bill.

are considering using spectrum auctions to license PCS. The Communications Act of 1934 currently does not permit the FCC to use auctions to license technology. Consequently, Congress must first authorize the FCC to use spectrum auctions. Then, the FCC will have to decide whether a spectrum auction for PCS is in the public interest and what safeguards need to be imposed to protect small businesses.

The FCC currently licenses technology three different ways: 1) on a first come-first serve basis for common carriers, 2) comparative hearings⁶ for broadcasting, and 3) lotteries⁷ for wireless cable and other media of mass communication. The revenue potential from auctions and the problems associated with comparative hearings and lotteries have lead to consideration of spectrum auctions as an alternative.

The comparative hearing process is attractive because it allows qualitative merit and preferences to be factored into the licensing process to achieve the important policy goals of diversity and localism. The problems with the comparative hearing process are that it is very time consuming, costly, and burdensome administratively.⁸

A lottery system is attractive because the Commission can handle large volumes of applications in less time; it is a more effective and objective way of narrowing groups of applicants and takes the politics out of the process initially; and it is flexible and can be used with the comparative hearing process. The problems with lotteries are that they are subject to abuse through

⁵ The FCC has solicited comments on spectrum auctioning including what part of the spectrum to be allocated for PCS, how should it be licensed, who should be eligible for a license, and how to ensure that small and minority businesses can participate.

⁶ A comparative hearing is authorized under 47 U.S.C. 309. The FCC uses this process to evaluate the qualitative merits of competing applicants and proposed services. This process involves comparing mutually exclusive applicants, i.e., applicants interesting in providing the same service in the same area over the same frequency. Qualitative factors which are weighed by the Commission include diversification, integration, program service, substantially good or bad past broadcast, efficient use of frequency through engineering considerations, and character, only

application mills and scams⁹; a person can spend a lot of money with little tangible benefit; and some believe it is an arbitrary way to address the public interest standard.

The FCC has also used other devices to achieve the policy goals of diversity, localism, and incentives to encourage the development of new technology. Among these devices are preferences¹⁰, which give an enhancement to an applicant for minority ownership¹¹ or innovation in technology¹²; and tax certificates, which allow sellers and investors to defer gain on the sale of their station if they sell and/or invest in a station which is owned and controlled by minorities. The tax certificate program has also been used to minimize the hardship to licensees who seek to upgrade to new technology or move to other frequencies in the band.¹³ Both preferences and tax certificates have an additional value in that they can be used with other licensing devices.¹⁴

Current proposals for spectrum auctions include using some combination of lotteries and preferences with an auction where the highest bidder would get the license, assuming other qualifications have been met. For example, under one proposal,¹⁵ interested parties

⁹ Larry Jaffee, "Cable License Scams Are Growing, Trade Group Says; FTC Files Suits," DM NEWS, p 3 (April 27, 1992)

¹⁰ Preferences are currently used in licensing mass media to promote diversity of ownership and encourage minority ownership. Preferences have been effective in increasing minority ownership in mass media, but have only been used where qualitative data on the applicant is considered in licensing.

¹¹ The FCC has awarded preferences in mass media to applicants who are owned or controlled by minorities who will be integrated into the operation and management of the facility. See In re Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, 92 FCC 2d 849, 858-59 (1982).

¹² The FCC can grant a "pioneer preference" to entrepreneurs to introduce new services or ways to use the radio frequency more efficiently. COMMUNICATIONS WEEK, supra note at 25.

¹³ In re Technical Assignment Criteria for the AM Broadcast Service, 6 FCCR 6273, 6325 (1991)

¹⁴ See In re Amendments of the Commissions's Rules to Allow the Selection from Among Competing Applicants for New AM, FM, and Television Stations by Random Selection (Lottery), 4 FCCR 2256, 2269 n. 67 (1989)

¹⁵ Communications Daily, supra note at 4.

would submit sealed bids for a license. If there is only one highest bidder then that applicant would get the license upon payment of the bid amount, if they are otherwise qualified. If there are 2 or more applicants filing highest bids, then a lottery would be used to choose the winner, again assuming the applicant is otherwise qualified. Any loser could appeal to the courts. If the case is remanded to the FCC, the auction and/or lottery would be repeated.

Spectrum auctions have created a lot of debate, primarily because it is perceived as favoring deep pocket companies over small businesses¹⁶, and undermining the public interest standard¹⁷ imposed by the Communications Act of 1934¹⁸. Moreover, many fear that if auctioning proves to be ineffective, the economic hardship of any remedial efforts, including divestiture, would be impractical and unlikely.

The advantages of spectrum auctioning are that it could be a revenue source to fund other programs for small business and/or minorities to promote diversity; it can assist the federal government in off-setting the federal deficit by allowing the government to capture a windfall (although some argue that the amount of revenue generated is speculative); it arguably gives preference to those most financially capable of taking advantage of the spectrum; and takes less time and is less burdensome than comparative hearings.

¹⁶ It is felt that growing trends in telecommunication toward consolidation and vertical integration by large companies will result in closing out small businesses, which will impede innovation, encourage collusion among large companies.

¹⁷ It has been a longstanding view that the spectrum belongs to the public and that a licensee has a duty to the public, as does the FCC to safeguard the public's interest. Auctioning is perceived to eliminate the public trust view of the license by conferring a property interest to the licensee, thereby giving the licensee contractual and tort rights, as well as a renewal expectancy which will limit the enforcement powers of the FCC.

¹⁸ See Peter Pitsch, "Perspective--Sold on Auctions", COMMUNICATIONS WEEK p 13 (March 18, 1991); Joe Flint, "Inoye Wants Radio, TV Exempt from Auctions," BROADCASTING & CABLE p 36 (March 22, 1993)

II. Outstanding Issues Regarding Auctions

There are several general issues which need to be resolved about auctions generally before the extent and nature of the impact on small business can be determined. The first issue is when should auctions be used. i.e. for broadcasting and other mass media 19

additional incentive to defer capital gain on any disposition.²¹ However, it would also mean that effective enforcement mechanisms needed to be in place to prevent abuse.

Fourth, Congress and the FCC must decide who should get the revenue generated from auctions. If a portion of the revenue is used for telecommunications training, research and development grants, and/or financial assistance for small and minority businesses, then spectrum auctions can benefit small business, particularly if entry requirements are reasonable. If, however, the revenue generated is not reinvested to some extent back into the telecommunications industry, entrepreneurs and innovation will undoubtedly suffer.

Finally, the FCC must implement effective enforcement

to submit a Small Business Initiative Plan, which could set forth
1) how the applicant intended to incorporate small businesses and
minorities into the construction, operation, and management of the
system; 2) targets for contracting with small business, minority
and/or women equipment and service vendors; 3) the percentage of
minority representation to be hired which are as stated above.